# **Internal Revenue Service**

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Department of the Treasury Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

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Date:

June 4, 2010

# Index

Fund 1

Fund 2

Series Fund

Total Return Index

Excess Return Index

Total Return Sub Index =

Excess Return Sub Index =

a = b = c = d = Country = Type A Company =

Dear :

This responds to the request dated February 25, 2010, submitted by your authorized representative on behalf of the Funds. Funds request that the Internal Revenue Service rule: (1) that income earned from investments in the commodity-linked notes described in this letter constitutes qualifying income to the Fund under section 851(b)(2) of the Internal Revenue Code of 1986, as amended ("the Code"), and (2) that income earned from an investment in a foreign corporation subsidiary of each of the Funds constitutes qualifying income to the Funds under section 851(b)(2).

## **Facts**

Series Fund is organized as a series fund and is registered as an investment company under the Investment Company Act of 1940, 15 U.S.C. 80a-1 <u>et seq.</u>, as amended ("1940 Act"). Fund 1 and Fund 2 (each a "Fund," and collectively the "Funds") are each a series of Series Fund, are open-end funds, are regulated as investment companies under the 1940 Act, and have elected or will elect to be taxed as regulated investment companies (RIC) under subchapter M of the Code.

# **Commodity-Linked Notes:**

The Funds intend to invest in commodity-linked notes having the terms and conditions of the following four notes (the Notes):

## Note A:

The first note will be issued at a par value of  $\$\underline{a}$ . Its payout formula will be determined with reference to the value of a Total Return Index. The term of the Note will be thirteen months. A Fund, as holder of the Note, will have the right to put Note A to the issuer at the calculated redemption price based on the closing Total Return Index value as of the end of the next day after notification to the issuer. In addition, if the Total Return Index value falls  $\underline{b}\%$  from the value at the time Note A is acquired, Note A will "knock-out" and automatically redeem based on a redemption price calculated using the closing Total Return Index value of the next day.

The repayment obligation upon early redemption, automatic redemption, or maturity is calculated under a formula that provides for repayment of the face amount of Note A increased or decreased by an amount equal to the face amount of Note A multiplied by a leverage factor of  $\underline{c}$  multiplied by the percentage of the increase or decrease of the beginning Total Return Index value level compared to the ending Total Return Index value level for the applicable period. To this amount is added an amount that reflects interest on Note A at a coupon rate of  $\underline{d}$ . From this amount is subtracted an annual fee amount of  $\underline{e}$  basis points of the notional value (leveraged face amount) of Note A. The redemption price formula under this Note will also include an adjustment for the reversal of the interest rate factor included in the total return computation.

## Note B:

Note B will be issued at a par value of  $\$\underline{a}$ . Its payout formula will be determined with reference to the value of an Excess Return Index. The term of the Note will be thirteen months. A Fund, as holder of the Note, will have the right to put Note B to the issuer at the calculated redemption price based on the closing Excess Return Index value as of the end of the next day after notification to the issuer. In addition, if the Excess Return Index value falls  $\underline{b}\%$  from the value at the time Note B is acquired, Note B will "knock-out" and automatically redeem based on a redemption price calculated using the closing Excess Return Index value of the next day.

The repayment obligation upon early redemption, automatic redemption, or maturity is calculated under a formula that provides for repayment of the face amount of Note B increased or decreased by an amount equal to the face amount of Note B multiplied by a leverage factor of  $\underline{c}$  multiplied by the percentage of the increase or decrease of the beginning Excess Return Index value level compared to the ending Excess Return Index value level for the applicable period. To this amount is added an amount that reflects interest on Note B at a coupon rate of  $\underline{d}$ . From this amount is subtracted an annual fee amount of  $\underline{e}$  basis points of the notional value (leveraged face amount) of Note B.

## Note C:

Note C will be issued at a par value of  $\$\underline{a}$ . Its payout formula will be determined with reference to the value of a Total Return Sub Index. The term of the Note will be thirteen months. A Fund, as holder of the Note, will have the right to put Note C to the issuer at the calculated redemption price based on the closing Total Return Sub Index value as of the end of the next day after notification to the issuer. In addition, if the Total Return Sub Index value falls  $\underline{b}\%$  from the value at the time Note C is acquired, Note C will "knock-out" and automatically redeem based on a redemption price calculated using the closing Total Return Sub Index value on the next day.

The repayment obligation upon early redemption, automatic redemption, or maturity is calculated under a formula that provides for the repayment of the face amount of Note C increased or decreased by an amount equal to the face amount of Note C multiplied by a leverage factor of  $\underline{c}$  multiplied by the percentage of the increase or decrease of the beginning Total Return Sub Index value level compared to the ending Total Return Sub Index value level for the applicable period. To this amount is added an amount that reflects interest on Note C at the coupon rate of  $\underline{d}$ . From this amount is subtracted an annual fee amount of  $\underline{e}$  basis points of the notional value (leveraged face amount) of Note C. The redemption price formula will also include an adjustment for the reversal of the interest rate factor included in the total return computation.

#### Note D:

Note D will be issued at a par value of  $\$\underline{a}$ . Its payout formula will be determined with reference to the value of an Excess Return Sub Index. The term of the Note will be thirteen months. A Fund, as holder of Note D, will have the right to put Note D to the issuer at the calculated redemption price based on the closing Excess Return Sub Index value as of the end of the next day after notification to the issuer. In addition, if the Excess Return Sub Index value falls  $\underline{b}\%$  from the value at the time Note D is acquired, Note D will "knock-out" and automatically redeem based on a redemption price calculated using the closing Excess Return Sub Index value calculated on the next day.

The repayment obligation upon early redemption, automatic redemption, or maturity is calculated under a formula that provides for repayment of the face amount of Note D increased or decreased by an amount equal to the face amount of Note D

multiplied by a leverage factor of  $\underline{c}$  multiplied by the percentage of the increase or decrease of the beginning Excess Return Sub Index value compared to the ending Excess Return Sub Index value level for the applicable period. To this amount is added an amount that reflects interest on Note D at the coupon rate of  $\underline{d}$ . From this amount is subtracted an annual fee amount of  $\underline{e}$  basis points of the notional value (leveraged face amount) of Note D.

The Funds make the following representations with respect to these four Notes:

- (1) The issuer of the Notes has received or will receive payment in full of the purchase price of the Notes substantially contemporaneously with the delivery of the Notes:
- (2) The Funds, while holding the Notes, will not be required to make any payment to the issuer of the Notes in addition to the purchase price paid for the Notes, whether as margin, settlement payment, or otherwise, during the life of the Notes or at maturity;
- (3) The issuer of the Notes is not subject by the terms of the instrument to mark-to-market margining requirements of the Commodities Exchange Act, 7 U.S.C. 2, as amended (CEA); and
- (4) The Notes are not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA.

## Controlled Foreign Corporations:

Each Fund also plans to form a wholly-owned foreign corporation subsidiary (each a "Subsidiary," collectively the "Subsidiaries"). Each Subsidiary will be incorporated as a Type A Company under the laws of Country. Under the laws of Country, a Type A Company provides for limited liability for all holders of shares. A shareholder's liability is limited to the amount, if any, unpaid with respect to the shares acquired by the shareholder. The Subsidiaries will file protective elections on Form 8832 to be taxed as corporations pursuant to section 301.7701-3 of the Procedure and Administration Regulations.

The Funds represent that although the Subsidiaries will not be registered as investment companies under the 1940 Act, the Subsidiaries will comply with the requirements of section 18(f) of the 1940 Act, Investment Company Release No. 10666, and related SEC guidance pertaining to asset coverage with respect to investments that would apply if the Subsidiaries were registered under the 1940 Act.

Each Fund may invest a portion of its assets in its respective Subsidiary, subject to the diversification limitations of section 851(b)(3). The Subsidiaries will invest primarily in commodity-linked derivative instruments including swap agreements,

commodity options, futures and options on futures. The Subsidiaries may make other investments, including fixed income securities, either as investments or to serve as margin or collateral for the Subsidiaries' derivatives positions. The Subsidiaries may also invest directly in commodities.

Each Subsidiary will be wholly owned by its respective Fund and, as such, the Funds represent that the Subsidiaries will be classified as controlled foreign corporations. Each Fund will include its "subpart F" income attributable to its Subsidiary under the rules applicable to CFCs under the Code.

# Law and Analysis

Section 851(b)(2) provides that a corporation shall not be considered a RIC for any taxable year unless it meets an income test. Under this test, at least 90 percent of its gross income must be derived from certain enumerated sources. Section 851(b)(2) defines qualifying income, in relevant part, as —

dividends, interest, payments with respect to securities loans (as defined in section 512(a)(5)), and gains from the sale or other disposition of stock or securities (as defined in section 2(a)(36) of the 1940 Act) or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to [the RIC's] business of investing in such stock, securities, or currencies . . . .

Section 2(a)(36) of the 1940 Act defines the term "security" as –

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security (including a certificate of deposit) or on any group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Section 2(f)(1) of the CEA provides that the CEA is not applicable to a hybrid instrument that is predominantly a security. Section 2(f)(2) of the CEA provides that a hybrid instrument shall be considered to be predominantly a security if –

- (A) the issuer of the hybrid instrument receives payment in full of the purchase price of the hybrid instrument, substantially contemporaneously with the delivery of the hybrid instrument;
- (B) the purchaser or holder of the hybrid instrument is not required to make any payment to the issuer in addition to the purchase price paid under subparagraph (A), whether as margin, settlement payment, or otherwise, during the life of the hybrid instrument or at maturity;
- (C) the issuer of the hybrid instrument is not subject by the terms of the instrument to mark-to-market margining requirements; and
- (D) the hybrid instrument is not marketed as a contract of sale of a commodity for future delivery (or option on such a contract) subject to the CEA.

Section 2(f)(3) of the CEA provides that for purposes of section 2(f)(2)(C) of the CEA, mark-to-market margining requirements do not include the obligation of an issuer of a secured debt instrument to increase the amount of collateral held in pledge for the benefit of the purchaser of the secured debt instrument to secure the repayment obligations of the issuer under the secured debt instrument.

In addition, the flush language of section 851(b) of the Code provides that, for purposes of section 851(b)(2), there shall be treated as dividends amounts included in gross income under section 951(a)(1)(A)(i) or 1293(a) for the taxable year to the extent that, under section 959(a)(1) or 1293(c) (as the case may be), there is a distribution out of the earnings and profits of the taxable year which are attributable to the amounts so included.

Section 957 defines a controlled foreign corporation (CFC) as any foreign corporation in which more than 50 percent of (1) the total combined voting power of all classes of stock entitled to vote, or (2) the total value of the stock is owned by United States shareholders on any day during the corporation's taxable year. A United States shareholder is defined in section 951(b) as a United States person who owns 10 percent or more of the total combined voting power of all classes of voting stock of a foreign corporation. Each Fund represents that it will own 100 percent of the voting power of the stock of its respective Subsidiary. Each Fund is a United States person. The Funds therefore represent that the Subsidiaries will qualify as CFCs under these provisions.

Section 951(a)(1) provides that, if a foreign corporation is a CFC for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder of this corporation and who owns stock in this corporation on

the last day of the taxable year in which the corporation is a CFC shall include in gross income the shareholder's pro rata share of the CFC's subpart F income for the taxable year.

Section 952(a)(2) defines subpart F income to include foreign base company income determined under section 954. Under section 954(a)(1), foreign base company income includes foreign personal holding company income determined under section 954(c). Under section 954(c)(1), foreign personal holding company income includes (among other things): dividends, interest, royalties, rents, and annuities; gains in excess of losses from transactions in commodities (including futures, forward, and similar transactions but excluding certain hedging transactions and certain active business gains and losses); and, subject to certain exceptions, net income from notional principal contracts.

Subsidiaries' income from their investments in commodities and commodity-linked instruments may generate subpart F income. The Funds therefore represent that they will include in income their respective Subsidiary's subpart F income for the taxable year in accordance with section 951.

## Conclusion

Based on the facts as represented, we rule that income and gain arising from the Notes constitutes qualifying income to the Funds under section 851(b)(2) of the Code. We further rule that subpart F income of the Subsidiaries attributable to the Funds is income derived with respect to each Fund's business of investing in the stock of its Subsidiary and thus constitutes qualifying income under section 851(b)(2).

This ruling is directed only to the taxpayers who requested it, and is limited to the facts as represented by the taxpayers. Section 6110(k)(3) provides that this letter may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Thomas M. Preston
Thomas M. Preston
Senior Counsel, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)